

4.3 - Balance of Payments

1. Which one of the following would appear as a credit item in the French balance of payments on current account?

✓ A. The purchase by a Japanese company of a French hotel chain.
 B. Money sent by French residents to relatives abroad.
 C. Expenditure on local services by French soldiers stationed abroad.
 D. The expenditure of Italian tourists in France.

2. Which of the following represents an invisible export in the balance of payments of the United States?

✓ A. Payment of dividends to Japanese shareholders of Honda (USA).
 B. Spending by Japanese tourists in New York on restaurant meals.
 C. The purchase of an Australian company by an American firm.
 D. US aid to developing countries.

3. Which one of the following transactions would be recorded in the balance of payments accounts as a positive item for Alba, but a negative item for Bayona?

✓ A. An oil company from Alba develops an oil field in Bayona.
 B. Oil executives from Alba stay in hotels in Bayona.
 C. Petrol (gasoline) from a refinery in Alba is sold in Bayona.
 D. Petrol (gasoline) from Alba is taxed by the Bayona government.

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4. Which of the following would not be included in a country's balance of payments figures?

✓ A. Borrowing from the International Monetary Fund.
 B. Private investment in other countries.
 C. Exports and imports of goods and services.
 D. The terms of trade.

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5. Which one of the following is not included in the current account of the balance of payments?

✓ A. Export of cars.
 B. Foreign direct investment.
 C. Spending by tourists.
 D. Dividend payments on shares held abroad.

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6. Which of the following items would be recorded as negative in the balance of payments?

✓ A. Exports.
 B. Inward foreign investment.
 C. Additions to foreign exchange reserves.
 D. Interest payments from abroad.

7. The table below shows a simplified balance of payments.

	\$ million
Visible exports	500
Visible imports	420
Invisible exports	30
Invisible imports	110
Net capital transfers	70

The balance of payments on current account is

A. -\$70 million B. zero C. +\$70 million D. +\$80 million

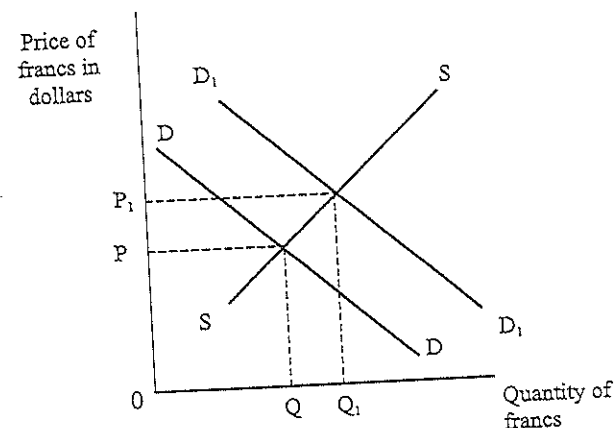
8. What will be the immediate effect on a developing country of opening its coastline to beach tourism?

✓ A. An improvement in the terms of trade.
 B. A worsening of the terms of trade.
 C. An improvement in invisible trade.
 D. An improvement in visible trade.

9. Which one of the following would be classified as an invisible export on the Malaysian Balance of Payments?
- A. The sale of Japanese machines to Malaysian companies.
 - B. Malaysian businessmen staying in Japanese hotels.
 - C. The sale of Malaysian computers to Japanese companies.
 - D. Japanese tourists travelling on Malaysian Airlines.

4.4 - Exchange Rates

1. The diagram below indicates the demand for and supply of francs in international money markets.

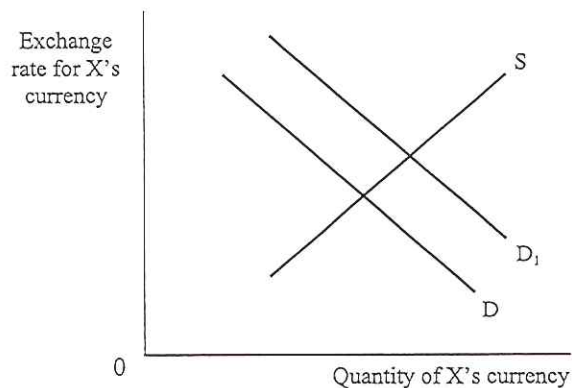


The increase in the price of francs in terms of dollars is most likely to have been caused by an increase in

- A. French interest rates relative to those in the USA.
- B. the price elasticity of demand for imports into France.
- C. the demand by France for goods from the USA.
- D. capital outflows from France.

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2. The diagram below shows the demand for and supply of the currency of Country X in international money markets.

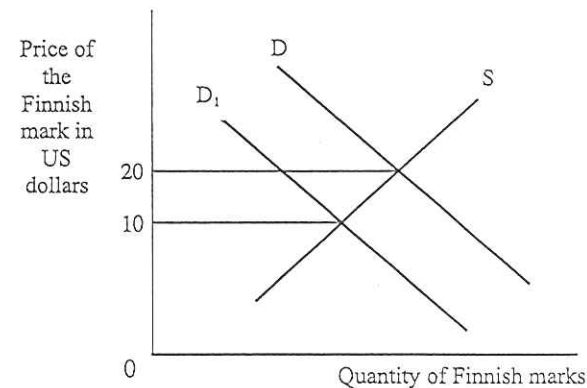


Other things being equal, a shift from D to D₁ would be the result of

- A. a deficit in the current account of the balance of payments of Country X.
- B. an increase in Country X's inflation.
- C. an inflow of foreign investment into Country X.
- D. a reduction in Country X's interest rates.

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3. The diagram shows the market for the Finnish mark.



A fall in the exchange rate from \$20 to \$10 could have been caused by

- A. lower interest rates in Finland.
- B. lower prices in Finland.
- C. less Finnish tourists travelling to the USA.
- D. reduced imports of American products into Finland.

4. Which of the following is most likely to increase the international demand for a country's currency?

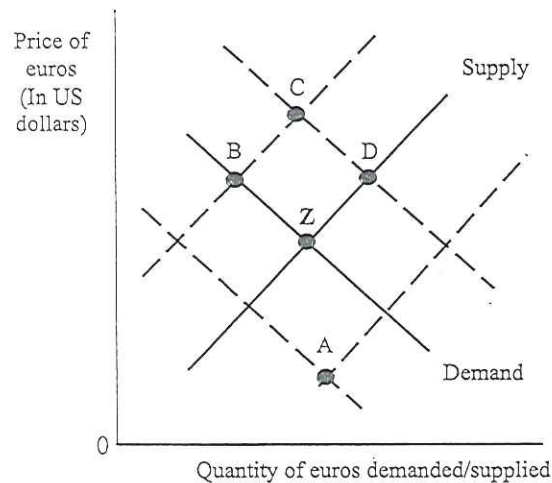
- A. Greater price competitiveness of the country in international markets.
- B. A fall in domestic interest rates.
- C. An increase in the country's rate of inflation.
- D. An increase in the productivity of workers in neighbouring countries.

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5. Other things being equal, which of the following would be most likely to decrease the price of the euro in terms of the Japanese yen?

A. Interest rates rise in Europe.
 B. The European Union imposes tariffs on Japanese goods.
 C. The European inflation rate is higher than the Japanese inflation rate.
 D. The number of Japanese tourists visiting Europe increases.

6. The diagram shows the demand and supply of the euro. The initial point of equilibrium is at Z. If there is an increase in American investment in Europe what will be the new point of equilibrium immediately following the investment?



A. A B. B C. C D. D

7. A flight of currency from country X occurs due to political instability. Which of the following is likely to happen as a result?

A. a fall in the exchange value of X's currency.
 B. a rise in the exchange value of X's currency.
 C. an upward revaluation of X's currency.
 D. a fall in X's interest rate.

8. The theory of purchasing power parity suggests that a currency's exchange rate changes to reflect differences in

A. the home country's inflation rate compared with other countries.
 B. movements in the international trade (business) cycle.
 C. the home country's real growth rate compared with other countries.
 D. relative interest rates in the home country and its trading partners.

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9. A basket of goods in Greece costs 25 drachma. The same basket of goods in Spain costs 125 pesetas. If all these goods are freely traded between the two countries, and the basket of goods is an accurate reflection of typical spending patterns, then it is likely that the drachma will exchange for

A. 0.2 pesetas.
 B. 2 pesetas.
 C. 5 pesetas.
 D. 100 pesetas.

10. A beefburger costs 8 pesos in Country A, and 10 dollars in Country B. If a beefburger is typical of all other goods, the idea of 'purchasing power parity' suggests that 1 peso will exchange for how many dollars?

A. 0.8 B. 1.0 C. 1.25 D. 4.5

11. Which exchange rate system was dominant in the world between 1945 and 1971?

- A. Adjustable peg.
 B. Gold standard.
 C. Free float.
 D. Dirty float.

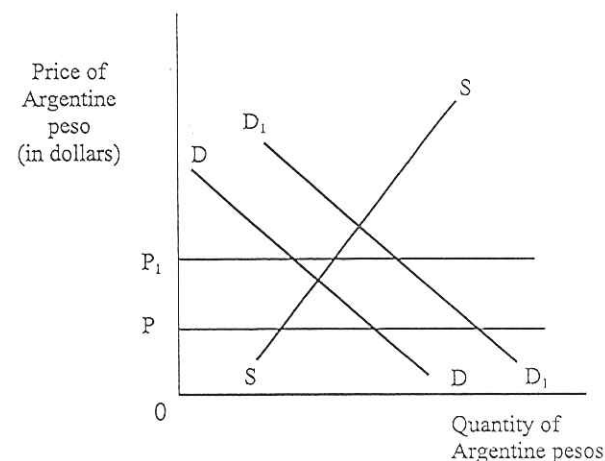
12. Which exchange rate system has been dominant in the world from 1972 to the present (2001)?

- A. Adjustable peg.
 B. Gold standard.
 C. Free float.
 D. Dirty float.

13. Which of the following characteristics is **not** an advantage of floating exchange rates?

- A. The balance of payments are self-correcting.
 B. International currency shortages do not occur.
 C. Central banks do not have to hold currency reserves.
 D. Businesses enjoy exchange rate certainty.

14. Suppose that the monetary authorities of Argentina are committed to maintaining the exchange of the Argentine peso against the U.S. dollar between P and P_1 on the diagram below.



What action might the monetary authorities of Argentina take if the demand for the peso changes from D to D_1 ?

- A. Raise the general level of interest rates.
 B. Sell dollars on the foreign exchange market.
 C. Subsidise domestic producers engaged in exporting.
 D. Sell Argentinian pesos on the foreign exchange market.

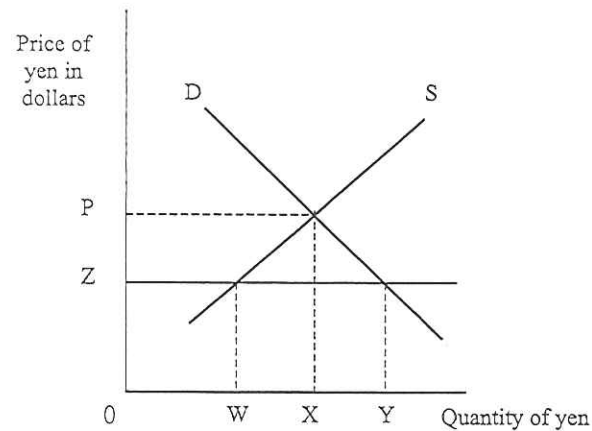
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15. A country could offset a downward movement in its exchange rate by

- A. the sale of domestic currency by the Central Bank.
 B. increasing interest rates.
 C. increasing its foreign exchange reserves.
 D. reducing import taxes.

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16. The diagram below shows the determination of the exchange rate of the Yen.



If the central bank of Japan wished to intervene in the free market to maintain an exchange rate of OZ it should

- A. buy WY yen.
- B. buy WX yen.
- C. sell WY yen.
- D. sell WX yen.

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17. Which of the following describe expenditure switching as opposed to expenditure reducing?

- I. A fall in the rate of inflation making domestically produced goods more competitive in comparison to imports.
- II. An increase in the demand for exports resulting from relatively lower export prices.
- III. Economic recession leading to less demand for imported consumer goods, raw materials and capital goods.

- A. I only B. I and II only C. II and III only D. I, II and III

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18. Participation by a group of countries in a common currency means that for an individual country

- I. the possibility of restoring competitiveness by means of devaluation would be lost.
- II. control over monetary policy would be lost.
- III. foreign exchange dealing costs would be eliminated for trade within the zone of the currency.

- A. I only B. I and II only C. II and III only D. I, II and III

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Questions 19 and 20 are based on the table below which indicates alternative price elasticities of demand for the imports and exports of country Y.

Combination (x + m)	Exports (x)	Imports (m)
A	0.4	0.6
B	0.5	0.3
C	0.9	1.1
D	1.5	1.5

Following a depreciation of the external exchange rate of country Y, other things being equal,

19. which combination of price elasticities would be most likely to bring about an improvement in the balance of payments on current account?

- A. A B. B C. C D. D

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20. which combination of price elasticities would be most likely to worsen the balance of payments on current account?

- A. A B. B C. C D. D

21. When a country devalues its currency under a managed exchange rate system the balance of payments may worsen before improving. This is known as

HL
A. the Marshall-Lerner condition.
B. the J-curve effect.
C. expenditure switching.
D. an adjustable peg.

22. A deterioration in the terms of trade means

HL
A. a fall in the average price of exports relative to the average price of imports.
B. a fall in the average price of raw materials relative to the average price of manufactured goods.
C. a higher volume of imports relative to the volume of exports.
D. a fall in the average price of imports relative to the average price of exports.

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23. The terms of trade must be moving in a country's favour when

HL
A. there is a rise in both its import and export prices.
B. the revenue from export earnings exceeds import expenditure.
C. there are net capital inflows.
D. its export prices are rising at a faster rate than its import prices.

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24. If the terms of trade of a country have deteriorated, then its

HL
A. imports have become more expensive relative to exports.
B. balance of payments has improved.
C. foreign currency reserves have fallen.
D. currency has appreciated.

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25. A country will experience a favourable movement in its terms of trade when

HL
A. its exchange rate falls.
B. the value of its exports rises more than that of its imports.
C. its import prices rise less than its export prices.
D. its export prices fall more than its import prices.

26. Other things being equal a country's terms of trade will improve if

HL
A. its currency appreciates.
B. the average price of imports rises and the average price of exports falls.
C. the average price of exports falls faster than the average price of imports.
D. the total value of imports rises more slowly than the total value of exports.

27. The table below refers to a particular country

	Index of Import Prices (1995 = 100)	Index of Export Prices (1995 = 100)
1993	90	92
1997	110	128

From the information given it can be concluded that

HL
A. the balance of trade worsened.
B. the balance of trade improved.
C. the terms of trade improved.
D. the terms of trade deteriorated.

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28. The following table shows the relationship between import and export prices for a country.

HL

Index of Export Prices		Index of Import Prices	
Year 1	Year 2	Year 1	Year 2
100	110	100	80

What is the terms of trade index in Year 2?

- A. 190 B. 137.5 C. 72.7 D. 1.375

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29. In Less Developed Countries that are heavily dependent upon a few primary exports the terms of trade tend to be

- HL
- A. stable in the short run and declining in the long run.
 - B. volatile in the short run and declining in the long run.
 - C. stable in the short run and improving in the long run.
 - D. volatile in the short run and improving in the long run.